Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition for Forbearance From	)	WC Docket No. 03-157
the Current Pricing Rules for	)	
the Unbundled Network Element	)	
Platform	)	

REPLY COMMENTS OF VERIZON TELEPHONE COMPANIES IN SUPPORT OF PETITION FOR EXPEDITED FORBEARANCE

Of Counsel:
Michael E. Glover

Karen Zacharia
Leslie V. Owsley
Donna M. Epps
Verizon
1515 North Court House Road
Fifth Floor
Arlington, Virginia 22201
(703) 351-3100

Lynn R. Charytan
Samir C. Jain
Wilmer, Cutler & Pickering
2445 M Street, NW
Washington, DC 20037-1420
(202) 663-6000

Evan T. Leo
Kellogg, Huber, Hanser, Todd & Evans
1615 M Street, NW
Washington, DC 20036
(202) 326-7900

Counsel for Verizon Telephone Companies

September 2, 2003

SUMMARY

As Verizon showed in its forbearance petition, the overwhelming evidence demonstrates that the application of the current pricing rules to UNE-P is deterring investment and impeding facilities deployment by all carriers and harming the health of the telecommunications industry. Immediate steps are necessary to remedy this situation, and, as an interim measure, the Commission should grant Verizon's petition and forbear from the application of the TELRIC pricing rules to UNE-P and from its rule permitting UNE-P carriers — rather than the incumbents that actually provide exchange access service — to collect per-minute access charges.

In response to Verizon's petition, the CLECs fall back to a strategy that can best be described as "deny, dissemble, and delay."

First, they deny that the UNE-P pricing rules have deterred telecommunications investment, insisting that investment is not depressed or that UNE-P pricing is not the cause. But their position is contradicted by the objective reports of numerous independent analysts. These analysts, who do not share the CLECs' incentive to downplay the effects of UNE-P pricing and have a vested interest in providing unbiased analyses, have overwhelmingly concluded that the UNE-P pricing rules have materially contributed to the massive decline in investment in telecommunications facilities. Further, the CLECs' *own* statements to their investors reveal that they have relied on the substantial profit margins afforded by UNE-P to the detriment of pursuing facilities-investment. And this same trend is illustrated by the undeniable empirical evidence, which shows a decline in facilities investment by all carriers, and increasing use of UNE-P. Indeed, the evidence even shows that CLECs that already have deployed their own facilities are increasingly finding that it is cheaper to serve their customers over UNE-P, rather

than using those existing facilities. Most remarkable of all, because even the CLECs obviously recognize that their factual claims are facially untenable, they ultimately are left to deny that investment and innovation are even desirable in the first place. Indeed, they go so far as to characterize investment in competing facilities as "inefficient" and "wasteful," and claim that building competing facilities is "pure folly." Congress and this Commission, of course, have determined otherwise.

Second, the CLECs dissemble: while they concede that UNE-P prices have dropped radically in recent years, they portray that decline as reflecting real decreases in costs. But they do not point to one example of a technological change or other data that would support that contention. Nor could they: The current, below-cost UNE-P prices result from the increasingly hypothetical assumptions that states have used in their cost proceedings, and that the Commission has adopted both through the 271 benchmarking process and in arbitrations. The CLECs similarly dissemble in an effort to protect the windfall they receive when they collect access charges. They pretend that when they take UNE-P, they perform some service that should be treated as providing exchange access to IXCs. But it is the incumbent that provides the exchange access, as the Commission already has recognized in the identical context of resale, and the UNE-P CLECs can point to nothing that distinguishes the two when it comes to providing exchange access service.

Third, the CLECs seek to delay resolution of the relief Verizon seeks by arguing that the Commission has no authority to grant the petition. But their various arguments fail to recognize that neither UNE-P itself nor the TELRIC pricing rules is "required" by the Act, and thus the Commission is free to forbear from them. And the fact that the Commission will be considering the broader TELRIC pricing rules in a future rulemaking proceeding does not provide an excuse to forego forbearance here as an interim step while that broader proceeding goes forward. Nor can this petition be put off on the theory that it simply seeks to relitigate the issues decided in the *Triennial Review Order*: Verizon's petition seeks forbearance only with respect to the *pricing* of UNE-P, which was not addressed in that *Order*.

Forbearance would end the system of uneconomic arbitrage created by the current UNE-P pricing rules and encourage the facilities-based competition that will provide greater genuine competitive choices for consumers. Thus, forbearance is in the public interest, and the Commission should grant this petition expeditiously.

TABLE OF CONTENTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition for Forbearance From the Current Pricing Rules for the Unbundled Network Element Platform	))))	WC Docket No. 03-157

REPLY COMMENTS OF VERIZON TELEPHONE COMPANIES IN SUPPORT OF PETITION FOR EXPEDITED FORBEARANCE

As Verizon demonstrated in its forbearance petition, the overwhelming evidence demonstrates that the application of the current UNE-P pricing rules is deterring investment, impeding facilities deployment by all carriers, and harming the health of the telecommunications industry and the economy as a whole. Even while it engages in a broader reform of the TELRIC pricing rules, the Commission should expeditiously take the two interim steps Verizon requests in its petition to ameliorate the most harmful effects of its rules: forbear from the application of TELRIC to UNE-P and eliminate the fiction that UNE-P carriers provide exchange access service and forbear from the rule permitting UNE-P carriers — rather than incumbents — to collect per-minute access charges.

Nothing in the hundreds of pages of comments filed by the CLECs shows otherwise. Instead their arguments amount to a strategy of "deny, dissemble, and delay." The record makes clear that the dramatic decline in investment in the industry and the devaluation of existing telecommunications infrastructure are in substantial part a direct result of the increased use of TELRIC-based UNE-P. The Commission has full authority to address this market distortion and should do so expeditiously. While the Commission indicated in the *Triennial Review Order* that it would soon embark on a proceeding designed to reform UNE pricing generally, the relief requested here is necessary now as an interim measure in order to ameliorate the most harmful aspects of the current UNE pricing rules while the broader reform of those rules proceeds.

I. NOTWITHSTANDING CLEC DENIALS, THE RECORD DEMONSTRATES THAT THE CURRENT UNE-P PRICING RULES HAVE DETERRED INVESTMENT AND HARMED THE DEVELOPMENT OF FACILITIES-BASED COMPETITION.

The evidence unequivocally demonstrates that the UNE-P pricing rules have produced a system of uneconomic arbitrage by grossly understating ILEC costs while providing huge margins for UNE-P carriers. The result has been to discourage all carriers — incumbents, CLECs, and intermodal carriers alike — from investing in telecommunications infrastructure, to devalue existing telecommunications investment, and to impede the development of a rational wholesale market. Although the CLECs try to deny these effects, they produce no evidence to refute them. To the contrary, the conclusions reached by numerous independent analysts, the CLECs' own statements to their investors, and the empirical evidence all confirm the harmful consequences of the current UNE-P pricing rules.

As an initial matter, there can no longer be any serious question that the TELRIC rules are themselves flawed and produce rates that are below any rational measure of costs. Most fundamentally, as the CLECs concede, TELRIC does not base prices on the realities of the incumbent's existing network or even on how that network is expected to evolve in the real world. *See, e.g.*, MCI Comments at 30 (TELRIC "assumes a hypothetical competitive market as a means of *designing* the benchmark network"). To the contrary, TELRIC functions as a "black box" that is entirely untethered from the existing network, and is instead based on conceptions of the hypothetically most efficient technologies and network configuration. In fact, pressure to produce the appearance of competition by providing CLECs what they claim is a "sufficient" profit margin between UNE prices and retail rates has led to the adoption of even more radical technology and operational assumptions, and thus to the constant ratcheting down of UNE rates over time. *See* Verizon Petition at 2-3. The resulting rates are well below what the incumbent, or any other carrier, could ever match. Indeed, the Commission itself noted in its *Triennial Review Order* that, even for an entrant that is wholly unencumbered by an existing network and can take advantage of all the newest technologies and most efficient network configuration — and therefore enjoys a competitive *advantage* compared to an incumbent — "the costs of self-providing . . . elements is likely much higher than obtaining them from the incumbent priced at TELRIC."[1/] As Chairman Powell has recently reconfirmed, UNE rates based on TELRIC are "subsidized and below costs."[2/]

The problems with TELRIC are particularly acute when the rules are applied to UNE-P. Pricing UNE-P at these extremely low TELRIC rates creates a system of uneconomic arbitrage in which the rates grossly underestimate any meaningful measure of the incumbent's costs, while allowing UNE-P carriers to reap huge margins without making any investments.

Numerous independent analysts have recognized that the application of TELRIC has produced UNE-P rates that are below the incumbent's costs. In just the past few weeks, for example, Fulcrum Global Partners has reiterated that TELRIC-based UNE-P amounts to "subsidized local competition" that permits CLECs to "ride the RBOC shareholder's investment

---

1/ Report and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, FCC 03-36 ¶ 517 n.1581 (rel. Aug. 21, 2003) ("*Triennial Review Order*").

2/ Jeremy Pelofsky, *FCC Chief Denies Leaving, Outlines Media Agenda*, Reuters News Serv., Aug. 19, 2003.

for next to nothing."[3/] Similarly, Commerce Capital Markets conducted a comprehensive analysis of UNE rates and concluded that "[f]or all RBOCs, UNEs are priced below cash operating cost, and radically below total operating cost including depreciation and amortization. The discounts from total cost are *50%-60%* below total cost even when total cost does not include cost of equity . . . ."[4/] The end result, as J.P. Morgan found, is that "[w]hile the Bells lose roughly 60% of the revenues when they lose a line to a UNE-P based competitor, we estimate that they retain 95% of the costs."[5/] The rule that permits the UNE-P carrier to collect per-minute access charges further compounds the problems resulting from such uneconomic arbitrage by diverting access charge revenues that were designed to compensate incumbents for their network infrastructure costs.

At the same time that the current UNE-P pricing rules substantially understate ILEC costs, they provide UNE-P carriers with such substantial profit margins that it would be competitive malpractice in most cases for CLECs to invest in their own facilities rather than reap the windfall return provided by UNE-P without any investment risk. As the recent Fulcrum report observed, UNE-P results in "gross profit margins [for CLECs that] are often north of

---

3/ Gregory P. Miller & Chris Chapple, Fulcrum Global Partners, *Wireline Communications: UNE-P Remains in the Crosshairs* at 1, 3 (Aug. 18, 2003) ("*Fulcrum Report*").

4/ Anna M. Kovacs, et al. Commerce Capital Markets, Inc., *The Status of 271 and UNE-Platform in the Regional Bells' Territories* at 15 (May 1, 2002) (emphasis added); *see also id.* ("[R]egulators are forcing RBOCs to wholesale their network at rates that are significantly below the costs that the financial community looks at.").

5/ M. Crossman, et al., J.P. Morgan Securities, Inc., *Industry Update – No Growth Expected for Bells in 2003* at 15 (July 12, 2002).

50%."[6] Likewise, a Legg Mason study showed that UNE-P yields average gross margins ranging from *47% to 66%* in numerous Verizon states.[7]

AT&T criticizes these and other independent studies, and attacks the consultants who advertise large profit margins from UNE-P as purveyors of "Ponzi schemes." AT&T Comments, Att. B at 15. But AT&T itself is one of the principle purveyors of this Ponzi scheme, and these studies and consultants say nothing more than what CLECs are telling their own investors. AT&T's Consumer Services president and CEO, for example, has assured investors that AT&T is not "going into states where we don't have a *gross margin of 45 percent on the local.* That's kind of our threshold trigger to go in . . . ."[8] It appears that AT&T is able to attain that substantial profit margin fairly easily since it has already entered the local market in 13 of the larger states (representing over 60% of BOC access lines).[9] As a result of these margins, AT&T

6/ *Fulcrum Report* at 7; *see also* Vik Grover & Richard Fetyko, Kaufman Bros., *Verizon Communications, Inc.* at 23 (July 14, 2003) (noting that UNE-P carriers have "gross margins of 45-55%").

7/ Michael J. Balhoff, et al., Legg Mason, *UNE-P Relief: Investors Expect Too Much* at 9 (Dec. 19, 2002). AT&T's criticisms of the Legg Mason study, *see* AT&T Comments, Att. B at 11-15, are without merit. For example, AT&T claims that the report fails to include costs associated with vertical services while including revenue from vertical services, even though the report explicitly includes a column calculating gross margins absent vertical service (and access) revenue. Similarly, AT&T suggests that the analysis is invalid because it excludes certain costs. AT&T Comments. Att. B at 12-13. But the UNE transport and signaling charges AT&T cites are so small that they will have little effect on the overall margin. And although the study excludes non-recurring costs, it also excludes the related non-recurring revenues.

8/ *Q2 2002 AT&T Earnings Conference Call – Final*, Fair Disclosure Wire, Transcript 072302au.729 (July 23, 2002) (statement of Betsy Bernard) (emphasis added).

9/ *See* AT&T Newsroom, *http://www.att.com/news/* (news releases announcing AT&T entry into New Jersey, California, Ohio, Illinois, Indiana, Michigan, Maryland, Virginia, Wisconsin, New York, Massachusetts, Georgia, and Texas). According to Commission data, these states represent approximately 63 percent of total BOC access lines. FCC Report 43-08, ARMIS Operating Data Report Table III, Column fi, Access Lines in Service by Customer: Total Switched Access Lines (2002).

is able to achieve "single customer payback as soon as 11 months," an extremely short time period for a new customer.[10/] The CLECs insist that these enormous margins can be explained away because CLECs incur marketing and retailing costs in addition to the amount they pay to incumbents for UNE-P. *See, e.g.*, AT&T Comments at 37; MCI Comments at 16. But even accounting for the 15-20% avoided costs that states have found carriers would bear for retail functions,[11/] the CLEC margins would remain substantial. Indeed, according to its own income statement, the use of UNE-P has allowed Talk America to attain a 20% *operating profit* (i.e., after taking into account marketing/retail costs).[12/] The company has explained that it can "lease the necessary elements of the Bell network — without the need for costly network infrastructure, which allows us to earn attractive gross margins."[13/]

10/ David Dornan, AT&T Chairman and CEO, Sanford Bernstein Strategic Decisions Conference at 10 (June 4, 2003).

11/ *See, e.g.*, Opinion and Order, *Implementation of the District of Columbia Telecommunications Competition Act of 1996 and Implementation of the Telecommunications Act of 1996*, Formal Case No. 962, 2002 D.C. PUC LEXIS 421, at ** 82-83 ¶ 76 (D.C. P.S.C. Dec. 6, 2002) (adopting 14.79% avoided cost discount rate); Opinion, *Petitions by AT&T Communications of the Southern States, Inc., MCI Telecommunications Corp. and MCI Metro Access Transmission Services, Inc., for Arbitration of Certain Terms and Conditions of a Proposed Agreement with GTE Florida Inc. Concerning Interconnection and Resale Under the Telecomm. Act of 1996*, Docket Nos. 960847-TP, 960980-TP, 1997 Fla. PUC LEXIS 71, at **145-46 (Fla. P.S.C. Jan. 17, 1997) (adopting 13.04% avoided cost discount rate).

12/ *Fulcrum Report* at 7 ("One has to look no further than the income statement of Talk America, with their approximate 20% operating profit margins, to see just how profitable UNE-P resale is with virtually no capital at risk.").

13/ Talk America, 2000 Annual Report at 7; Wayne Huyard, Chief Operating Officer, MCI, *Using UNE-P To Develop a Strong and Profitable Local Presence*, Goldman-Sachs Telecom Issues Conference, New York, NY (May 7, 2002); *see also* Talk America, Form 10-K/A at 6 (SEC filed Apr. 12, 2002) (Talk America "believes that UNE-P currently provides it with a cost-effective means of adding local service to its existing long distance product offerings.").

As numerous independent analysts have concluded, the result of this uneconomic arbitrage under which incumbents do not nearly recover their costs and UNE-P carriers reap substantial margins is to discourage investment by all carriers. As Scott Cleland of the Legg Mason Precursor Group observed, "why overbuild if one can lease it more cheaply than one can build it?"[14/] Similarly, McKinsey & Co. and J.P. Morgan have explained that the incentives created by applying TELRIC to UNE-P are clear: "[n]o company will deploy and scale facilities if it can achieve similar economics immediately by renting network elements from the ILECs – all with little up-front investment."[15/] Other analysts have likewise concluded that "[s]ix years following the Act, we are left with virtually no structural incentive for any company to ever build an alternative local network that will compete with local carriers over time"[16/] and that "under a more rational local competitive framework, overbuilding might have occurred to a greater extent."[17/] Simply put, "UNE-P functions like a tax on investment, rather than a competitive incentive."[18/]

14/ *Hearings before the Subcomm. On Telecommunications Trade & Consumer Protection of the House Commerce Comm.*, 106th Cong. 2 (May 25, 2000) (Written statement of Scott Cleland, Managing Director, The Precursor Group); *see also* S. Cleland, Precursor Group, *Why UNE-P Is Going Away: Telecom Competition's Changing Trajectory* (Oct. 2, 2002).

15/ McKinsey & Co. and J.P. Morgan H&Q, *Broadband 2001, A Comprehensive Analysis of Demand, Supply, Economics, and Industry Dynamics in the U.S. Broadband Market* at 18 (Apr. 2, 2001).

16/ Gregory P. Miller, et al., Fulcrum Global Partners, *Wireline Communications: Thoughts on FCC Order* at 2 (Feb. 25, 2003).

17/ B. Roberts, et al., Dresdner Kleinwort Wasserstein, *UNE-P: The Unprofitable RBOC* at 3 (Aug. 9, 2002).

18/ *See* Scott Cleland, Precursor Group, "*Why UNE-P Is Going Away: Telecom's Changing Trajectory*" (Oct. 2, 2002).

The conclusions reached by these independent analysts clearly are entitled to significantly greater weight than the self-serving assertions in the CLECs' comments. These analysts have every incentive to be thorough and objective. Their reputations hinge on the reliability and accuracy of their views. Moreover, their conclusions influence where investors, including their clients, put their money, and thus their own clients' money is at stake. In these circumstances, these analysts have a great deal to lose if they are wrong, and they have no reason to subjectively favor one segment of the industry over another.

Furthermore, the conclusions of these independent analysts are consistent with what CLECs themselves are saying to their investors. As one CLEC has explained, it "ha[s] chosen [UNE-P] to grow our customer base *because* it allows us to rapidly enter new markets with minimal capital expenditures."[19/] Similarly, numerous other CLECs have observed that reliance on UNE-P at current prices "allows us to avoid significant capital investments in network facilities" and permits entry "without the need for costly network infrastructure, which allows us to earn attractive gross margins."[20/]

The resulting decline in investment is demonstrated by the objective numbers. Existing investments by incumbents and entrants in telecommunications infrastructure have been substantially devalued. CLECs do not dispute that the market capitalization of the telecommunications and equipment manufacturing sectors, to take just one measure, has declined

---

19/ ELEC Communications, Form 10-Q (SEC filed July 17, 2000) (emphasis added).

20/ Z-Tel, 2001 Annual Report at ii; Talk America, 2001 Annual Report at 7; *see also* Talk America, Form 10-K at 6 (SEC filed March 30, 2003) (explaining that it uses UNE-P in part because it minimizes capital expenditures); Wayne Huyard, Chief Operating Officer, MCI, *Using UNE-P To Develop a Strong and Profitable Local Presence*, Goldman-Sachs Telecom Issues Conference, New York, NY (May 7, 2002).

by $2 *trillion* since 2000 alone.[21/] Similarly, the CLECs do not contest the massive decline in the pace of telecommunications investment in the past few years: a decline of more than $60 billion for wireline telecommunications carriers generally between 2000 and 2002 alone, and a decline of approximately 35 percent for Bell companies and 56 percent for CLECs from 2001 to 2002.[22/] Current levels of investment are even below the levels needed to maintain current plant.[23/] And contrary to the CLECs' claims, *see, e.g.*, AT&T Comments, Att. B at 27-28, Verizon's own investments are entirely consistent with this industry trend. From 2000 to 2002, Verizon's capital expenditures for its domestic wireline business dropped from approximately $12.1 billion to approximately $7 billion, a decline of over 40%.[24/]

Even while conceding this devaluation of existing investment and the dramatic fall-off in the pace of new investment, the CLECs inexplicably deny the significance or relevance of such developments. They assert that the massive decline is no more than a normal slowing of growth in investment, make the implausible assertion that the simultaneous rise in use of UNE-P and decline in investment are just a coincidence, and deride the development of facilities-based competition as "overinvestment." These assertions do not withstand scrutiny.

21/ *See, e.g.*, Steven Rosenbush, et al., *Inside the Telecom Game: How a Small Group of Insiders Made Billions as the Industry Collapsed*, Business Week 34 (Aug. 5, 2002); Paul Starr, *The Great Telecom Implosion*, The American Prospect 2024 (Sept. 9, 2002).

22/ Skyline Marketing Group, *CapEx Report: 2002 Annual Report*, Carrier Data Sheet 1 (June 2003); UBS Warburg, *Are the Bells Growing Less Profitable?* at 41 (April 16, 2003); Association for Local Telecommunications Services, *The State of Local Competition 2003* at 10 (Apr. 2003).

23/ Declaration of Thomas W. Hazlett, Ph.D., Prof. Arthur M. Havenner, and Coleman Bazelon, Ph.D. ¶ 23 (Sept. 2, 2003) ("Hazlett Decl.") (Attached hereto as Attachment A).

24/ Verizon Communications, Form 10-K at 18 (SEC filed Mar. 14, 2003).

The CLECs initially argue that the massive decline in investment is of no significance because new investment has not been eliminated altogether, and therefore overall investment (as measured in terms of "gross capital stock") is still growing. *See* AT&T Comments at 41, Att. B at 24-27; Z-Tel Comments at 41. But it makes far more sense to look to the change in the flow of net investment (i.e., changes in the rate of growth of investment) to examine the incentive effects of UNE-P. As the D.C. Circuit has explained, "the existence of investment of a specified level tells us little or nothing about incentive effects. The question is how such investment compares with what would have occurred in the absence of the prospect of unbundling." *USTA v. FCC*, 290 F.3d 415, 425 (D.C. Cir. 2002). In any event, "gross capital stock" — which fails to take account of more than $100 billion in accumulated depreciation — is obviously the wrong measure. As AT&T's own expert acknowledged in the *Triennial Review* proceeding, investment is properly measured as changes to "net capital stock" — gross capital less accumulated depreciation.[25/] And under this measure, even the primary study on which the CLECs rely concerning the relationship between UNE-P confirms that investment is in decline.[26/]

The CLECs next contend that, even if there has been a decline in investment, it cannot be attributed in any way to the regulatory regime. Instead, they argue, the decline should be attributed exclusively to the overall sluggishness of the economy and other macroeconomic

25/ *See* Robert D. Willig et al., *Stimulating Investment and the Telecommunications Act of 1996* (Oct. 11, 2002), at 12-13, filed with the FCC by AT&T, Docket 01-338, on Oct. 11, 2002 ("a measure of the net capital at the end of each year is constructed as the difference between the Total Plant in Service (TPIS) [i.e., gross capital stock] and the Accumulated Depreciation at the end of the year."). *Compare* AT&T Comments, Att. B at 5 n.1 ("As used herein, 'investment' means the addition to capital stock (*i.e.*, gross capital stock), as opposed to 'net' capital stock (*i.e.*, gross capital minus depreciation).").

26/ *See Competition and Bell Company Investment in Telecommunications Plant: The Effects of UNE-P*, Phoenix Center Policy Bulletin No. 5 at 1 (July 9, 2003) (in 2002 alone, "BOC net investment fell by about 7%").

factors. *See, e.g.*, AT&T Comments at 41-42; Sprint Comments at 14-15; MCI Comments at 37; WorldNet Comments at 5-6. While broader economic trends no doubt have had an effect on telecommunications investment, the claim that the unbundling rules have occurred in a vacuum, and had no effect on investment, is patently wrong. As explained above, independent investment analysts, who obviously are aware of the relevant broader economic trends, have nevertheless concluded that the current pricing rules for UNE-P have had a significant role in deterring investment.[27/] And the CLECs themselves have explained to investors that they "have chosen [UNE-P] to grow our customer base *because* it allows us to rapidly enter new markets with minimal capital expenditures."[28/]

The Commission itself likewise has recognized that the unbundling rules have a causal role in carriers' investment decisions: both the *UNE Remand* and *Triennial Review* orders are replete with discussions about what incentive effects particular unbundling rules will have on carriers.[29/] As the Commission explicitly noted, "unbundling requirements tend to undermine the incentives of both incumbent LECs and new entrants to invest in new facilities and deploy new technology." *Triennial Review Order* ¶ 3.

This depressing effect on investment is particularly evident with respect to the current pricing rules as applied to UNE-P. As the Commission itself explained in the *Triennial Review*

27/ *See, e.g.,* Adam Quiton, Merrill Lynch, *The Telecommunicator, Telecom Civil War: Post 2Q Update,* (Aug. 7, 2003) (attributing fact that the slump in capital expenditures continued in the first half of 2003 to the United States' "combination of structural, *regulatory* and other adverse factors") (emphasis added).

28/ ELEC Communications, Form 10-Q (SEC filed July 17, 2000) (emphasis added).

29/ *See, e.g., Triennial Review Order*, ¶¶ 96, 236, 244; Third Report and Order and Fourth Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3696 ¶¶ 14, 31, 104, 110 (1999) ("*UNE Remand Order*").

Order, even for entrants who have a competitive *advantage* over incumbents because they are unconstrained by an existing network and can utilize the newest, most efficient technologies, "the costs of self-providing . . . elements is likely *much higher* than obtaining them from the incumbent priced at TELRIC." *Id.* ¶ 517 n.1581 (emphasis added). As a result, the current pricing rules create a strong incentive for CLECs to use UNEs rather than invest in their own facilities. The availability of *UNE-P* at these rates exacerbates this effect, because with UNE-P (unlike other strategies that use UNEs only in part), a CLEC has to make no facilities investment at all. Thus, it utterly defies common sense to claim as the CLECs do that the current pricing rules for UNE-P have had no material role in reducing investment.

The market evidence also demonstrates that investment in the wireline industry, which is directly affected by UNE-P pricing, has suffered uniquely as compared to other sectors of the telecommunications market. For example, if one compares investment patterns in the wireline industry with experience outside of the wireline sector during the same period, it is clear that other telecommunications sectors that are not subject to UNE-P (or similar) unbundling requirements at TELRIC rates (or at all) have not suffered the same declines. Thus, investment in the wireless and cable markets has not dropped anywhere near as steeply as wireline investment, despite the fact that they were subject to most or all of the same macroeconomic factors to which the CLECs point. Hazlett Decl. ¶¶ 30-31.

Industry data further confirm that the UNE-P pricing rules have curtailed investment. As the Commission's data show, the number of CLEC-owned lines (other than cable telephony) declined from 4.1 million to 3.4 million even while the number of UNE-P lines skyrocketed from

2.8 to 10.2 million.[30] MCI responds by asserting that, if UNE-L lines are included, the absolute number of lines using CLEC-owned switches increased during this period. MCI Comments at 42-43 & n.102. But it is clear that UNE-P is growing at the expense of UNE-L: while CLEC lines using CLEC switches constituted 67% of CLEC lines in December 1999, that figure dropped to 35% by the middle of 2002.[31] Moreover, the decline in growth of UNE-L is particularly evident in states where UNE-P growth has been highest. As Chairman Powell has observed, "[i]n just eight of the states where carriers now make extensive use of UNE-P, competitors are connecting more than 45,000 fewer lines per month — or more than half a million *fewer* lines per year — to their own switches using unbundled loops compared to 2000." *Triennial Review Order*, Powell Statement at 6. In at least two of these eight states, the number of UNE-L lines has actually *decreased* in absolute terms. *Report on Negative Effect of the UNE Platform* at 16.

This decline in use of UNE-L in favor of UNE-P is significant since it cannot be explained by the sluggish economy and tight capital markets. In the states where this shift has occurred, CLECs already have incurred the investment costs to deploy switches (since they have at least some UNE-L customers); accordingly, their decision nevertheless to rely on UNE-P necessarily reflects the fact that UNE-P is more profitable even in the face of the CLECs' sunk

---

30/ *See Local Telephone Competition: Status as of December 31,* 2002, Ind. Anal. & Tech. Div., FCC, at Tables 5 & 10 (June 2003); *Local Telephone Competition: Status as of December 31,* 2002, Ind. Anal. & Tech. Div., FCC, at Tables 5 & 10 (May 2001); Verizon Petition, Att. B, *The Negative Effect of Applying TELRIC Pricing to the UNE Platform on Facilities-Based Competition and Investment*, at 20 ("*Report on Negative Effect of the UNE Platform*").

31/ R.E. Talbot, RBC Capital Markets, Investext Rpt. No. 7229059, *Integrated Telecommunication Services – Moderating Expectations for Triennial Review – Industry Report* at 13 (Feb. 18, 2003) ("We expect this trend to continue as CLECs pursue UNE-P based strategies in additional markets."); *see also* Qwest Comments at 5-6 (demonstrating correlation between UNE-P growth and UNE-L decline).

investment in their own switching capacity. Indeed, CLECs are even moving *existing* customers from their own switching facilities to UNE-P arrangements.[32] This industry trend demonstrates that the UNE-P pricing rules are discouraging use of, and therefore investment in, CLECs' own facilities.

Contrary to all this evidence, the CLECs nonetheless assert that UNE-P has *increased* investment by incumbents. This makes no sense. As a result of the UNE-P pricing rules, incumbents are competitively disadvantaged by investing in their networks: Any investment the incumbent makes in its wireline network is immediately available at TELRIC rates to UNE-P carriers, who can obtain the benefits of this investment without bearing the accompanying risks. Further, the two studies on which CLECs rely for their position use faulty analysis, and the Commission already has explicitly rejected one of them.

The CLECs first point to an AT&T study, *see e.g.*, AT&T Comments at 45-46, Att. A at 12-13; MCI Comments at 40, that the Commission criticized in the *Triennial Review Order*. Among other things, the Commission noted that the study was "methodologically suspect" because it measured incumbent investment per capita instead of investment per access line. *See Triennial Review Order* ¶ 178 n.576. The Commission further concluded that a number of the variables used in the study were "not well explained, subject to significant errors, and appear suspect lacking significant additional explanation."[33] The remaining study on which the CLECs

---

[32] *See, e.g.*, Ex Parte Letter from Jacob S. Farmer, Counsel for Birch Telecom, to Marlene Dortch, FCC, CC Docket Nos. 01-338, 96-98 at 2 (filed Mar. 31, 2003) (describing "customer migration effort to convert existing Birch customers served by Birch's switch to service provided by SBC's switch via UNE-P"); Verizon Petition at 9 & n.24.

[33] *Triennial Review Order* ¶ 178 n.576; *see also* Timothy J. Tardiff, *An Appraisal of Professor Willig's Econometric Analysis, Exhibits 2 and 3* (2002), submitted as Att. B App. 2 to Reply Comments of the Verizon Telephone Companies, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338 (July 17, 2002)

rely, conducted by the Phoenix Center, is similarly riddled with errors and is inconsistent with the conclusions independent analysts have uniformly reached. AT&T Comments, Att. B at 23; MCI Comments at 40-41. As an initial matter, the study claims that each UNE-P line has caused an increase in ILEC investment of $759. The study therefore implies that the addition of each UNE-P causes an increase in ILEC investment that is higher than the *total* amount of capital already in place for a non-UNE-P line. *See* Hazlett Decl. ¶¶ 33-34. That is nonsensical. Further, the study's basic methodology is flawed in a number of respects. *See id.* ¶¶ 35-36. Making adjustments for even just a small subset of the flaws eliminates the statistical correlation the study purports to find. *Id.* ¶ 37.

Finally, the CLECs contend that it does not matter that UNE-P has caused a decline in investment, because facilities-based competition (particularly in the mass market) is "inefficient" and "wasteful," MCI Comments at 38, and simply leads to "building redundant new assets" that is "pure folly," AT&T Comments at 46 & Att. B at 28. This remarkable position is not only a complete reversal from the CLECs' prior (erroneous) arguments that the preservation of UNE-P at TELRIC rates is a necessary prerequisite to facilities-based competition,[34/] but it is contrary to

---

(noting, among other things, that study illogically attempted to claim that UNE-P prices in 2001 had an effect on incumbents' investment decision from 1995-2000); John Haring et al., Strategic Policy Research, *UNE Prices and Telecommunications Investment* 3-5, submitted as Attachment B to Reply Comments of Qwest Communications Int'l Inc., CC Docket No. 01-338 (July 17, 2002) (noting same and that study used an unreliable measure of the level of competition).

[34/] *See, e.g.*, Comments of AT&T Corp. at V-VI, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338 (filed Apr. 5, 2002) ("The availability of UNEs will . . . promote facilities-based service for residential customers."); Comments of MCI WorldCom at 54, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98 (filed May 26, 1999) ("If CLECs are not able to build market share by serving customers with unbundled ILEC switching prior to deploying their own switches, then the business case for deploying a switch may be delayed or undermined altogether."); Ex Parte Letter from Robert W. Quinn, AT&T, to William F. Caton, the conclusion reached by Congress, the Commission, and the courts. The Commission recently reaffirmed its conclusion that the greatest benefit to consumers will be achieved through facilities-based competition, noting that "facilities-based competition serves the Act's overall goals," and explicitly "disagree[ing] that duplication of facilities is necessarily 'wasteful.'" *Triennial Review Order* ¶ 70 & n.233. As Justice Breyer succinctly explained, facilities-based competition is preferable because it is in "the unshared, not in the shared, portions" of the network that "meaningful competition" will emerge. *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 429-30 (Breyer, J., concurring).

II. THE CLECS DISSEMBLE BY SUGGESTING THAT THE DRAMATIC DROP IN UNE-P PRICES — WHICH HAS IMPEDED COMPETITION AND HARMED THE INDUSTRY — IS THE RESULT OF DECLINING COSTS.

While the CLECs concede that UNE-P prices have declined radically in recent years, they claim that these substantial UNE rate reductions — often 50% or more — are the result of corresponding declines in costs. *See, e.g.*, AT&T Comments Att. B at 6. But this is nothing more than dissembling: neither AT&T nor any other CLEC identifies a *single* technological or other change that has reduced the costs of providing UNEs since states began applying TELRIC. Indeed, during the same period that UNE rates began to drop, MCI (as WorldCom) actually told the Supreme Court that loop costs were *increasing*.[35] And it is simply implausible to assert that costs of providing UNEs are declining at the significant levels by which UNE rates have been decreased. Indeed, given factors such as rising costs for the labor needed to deploy facilities, the

---

FCC, CC Docket No. 01-347, at 11 (filed Mar. 1, 2002) (AT&T "cannot rationally invest in switches . . . until they have used UNE-P to build up a customer base.").

[35] Reply Brief for Petitioners WorldCom, Inc., et al. *WorldCom, Inc., et al. v. Verizon Communications, Inc.*, et al. at 5-6 (July 23, 2001).

increased costs for trenching in urban areas, and more expensive rights of way, in many respects costs for UNEs such as loops are actually increasing.

Rather than decreasing costs, the extraordinary drop in UNE-P rates is due to the adoption of increasingly extreme and hypothetical assumptions in section 252 cost arbitrations, through the Commission's section 271 benchmarking process, and in Commission staff decisions in arbitrations and universal service proceedings. The CLECs' own comments illustrate the ever more hypothetical assumptions that have been applied to ratchet UNE rates down. AT&T, for example, provides an extended narrative concerning the systematic reduction of UNE rates in various states. AT&T Comments, Att. C. The narrative illustrates Verizon's point: in all of the referenced states, the rates were initially set based on hypothetical assumptions, but were subsequently reduced in later cases based on increasingly extreme interpretations of TELRIC and increasingly hypothetical assumptions.

For example, AT&T's own description shows that, in reducing rates in more recent UNE cases, states have adopted entirely hypothetical fill factors rather than factors based on experience in running a real-world network that must provide service and meet applicable quality standards. *Id.* at 17 (Maine), 36 (Massachusetts). Likewise, UNE-P prices have been based on the clearly unrealistic assumption that 90% of total network switching capacity would be purchased at "new switch discounts" that can approach 95%, even though manufacturers clearly could not come close to recovering their costs at such discount levels — and therefore would not offer them — if carriers in fact bought most of their capacity at new switch prices. *Id.* at 34 (Massachusetts). The radically low UNE-P prices are also due in part to the use of cost of capital figures below 10% that do not account for the relevant competitive and regulatory risks faced by the incumbent under TELRIC. *Id.* at 17 (Maine), 58 (Pennsylvania). As the Commission has recently clarified, the cost of capital must include "the risks of a competitive market . . . . in which there is facilities-based competition" and "any [additional] unique risks . . . associated with new services that might be provided over certain types of facilities." *Triennial Review Order* ¶¶ 680, 683.

Moreover, AT&T omits from its report the many other extreme hypothetical assumptions that have been used in UNE proceedings to support the constant ratcheting down of rates. For example, recovery of line conditioning and loop qualification costs has been denied altogether on the theory that a "hypothetical network construct" would not incur those real-world costs.[36/] Rates similarly have been reduced on the assumption that all fiber loops consist of integrated digital loop carrier (IDLC) with GR-303 notwithstanding the reality that some services can only be provided over universal digital loop carrier and that no currently available technology makes it possible to unbundled standalone loops using GR-303.[37/] Indeed, the Commission itself has

---

36/ *Investigation by the Department of Telecommunications and Energy on Its Own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided-Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts*, D.T.E. 01-20, at 261 (MA D.T.E. July 11, 2002) ("Massachusetts UNE Order"); *see also* Order, *Investigation Into Rates for Unbundled Network Elements Pursuant to the Telecommunications Act of 1996*, Case No. 8879, at 124-131 (MD P.S.C. June 30 2003) ("MD Order") (prohibiting recovery of certain line conditioning costs because in a hypothetical "forward-looking network, there would be no copper loops in excess of 18,000 feet"); Opinion and Order, *Implementation of the District of Columbia Telecommunications Competition Act of 1996 and Implementation of the Telecommunications Act of 1996*, Formal Case No. 962, 2002 D.C. PUC LEXIS 421, at *409 (D.C. P.S.C. Dec. 6, 2002) ("DC Order") (prohibiting recovery of line conditioning costs because "AT&T's [hypothetical] network architecture would not have load coils or bridge taps, but instead be DSL ready").

37/ DC Order at *235, *262 (rejecting any use of TR-008 even while acknowledging that was the "technology used in the incumbent's embedded network" and instead assuming that all fiber loops must be IDLC GR-303 "in a forward-looking, least-cost configured network as TELRIC-complaint"); Tentative Order, *Generic Investigation re. Verizon Pennsylvania Inc.'s* acknowledged that "it is not technically feasible to unbundle an IDLC loop."[38/] And, notwithstanding these already drastic assumptions, AT&T argues that TELRIC requires rates to be lowered even *further* based on even *more* extreme hypothetical assumptions. *See, e.g.*, AT&T Comments, Att. B at 10, Att. C at 10-11, 36-37.

Despite the clear evidence demonstrating that the decline in UNE rates is due to adoption of these unrealistic and hypothetical assumptions, the CLECs assert that Verizon has *conceded* that costs are declining because it has proposed UNE rates in the second round of UNE proceedings that are in some cases lower than the pre-existing UNE rates and because incumbents have been required to reduce rates in the 271 process. Neither point supports the CLECs' claim. Verizon has consistently made clear that the rates it has been compelled to propose in UNE proceedings, given the constraints of TELRIC, are below its true costs. Verizon's proposals simply reflect the reality that states have consistently ratcheted down rates, and that proposing higher rates, though clearly a better reflection of Verizon's costs, is likely

---

Unbundled Network Element Rates, Docket No. R-00016683, at 80-81 (PA PUC Oct. 24, 2002) ("*PA Tentative Order*") (assuming that all fiber loops must be IDLC GR-303).

38/ Memorandum Opinion and Order, *Application by Verizon Virginia Inc., Verizon Long Distance Virginia, Inc., Verizon Enterprise Solutions Virginia Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia Inc., for Authorization to Provide In-Region InterLATA Services in Virginia*, 17 FCC Rcd 21880 ¶ 148 (2002) ("*Virginia 271 Order*"). Although the Commission in the *Triennial Review Order* and the staff in a recent arbitration decision have suggested that it may be possible to unbundle an IDLC-fed loop, both decisions recognize that such unbundling would require transferring such a loop to UDLC or copper or using an expensive and inefficient work-around. *See Triennial Review Order* ¶ 297 & n.855 (noting that "in most cases [unbundling an IDLC loop] will be either through a spare copper facility or through the availability of Universal DLC systems"); Memorandum Opinion and Order, *Petition of WorldCom, Inc. et al., Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc. and for Expedited Arbitration*, CC Docket Nos. 00-218, 00-251, ¶ 315 (rel. Aug. 29, 2003) ("*Virginia Arbitration Order*") (referring to unbundling IDLC loops by "migrating" the loop to UDLC).

only to result in a blanket rejection of Verizon's proposals. As to 271 proceedings, they have functioned only as one-way ratchets in which incumbents are forced to reduce specific rates to ensure approval of the 271 application. In particular, by effectively requiring incumbents to satisfy the benchmarking test by bringing rates down to levels comparable to rates in other states — rates which are themselves the result of extreme hypothetical assumptions — the 271 process has produced a race to the bottom for UNE rates that is unconnected to any actual decline in costs.

The only other "evidence" the CLECs cite for the proposition that UNE-P rates are not below cost is a paper — co-authored by Z-Tel's own in house economist — that purports to show that UNE-P is somehow "profitable to the BOCs," producing a net return of 7.01% above cost. *See, e.g.*, Z-Tel Comments at 42 (citing T. Randolph Beard et al., *The Financial Implications of the UNE-P Platform: A Review of the Evidence*, 20 (2003) ("Z-Tel Paper"). This paper is contrary to the conclusion reached by a host of independent investment analysts that have examined the issue. This is not surprising, since, among other things, its conclusions rest on a substantial understatement of incumbents' costs. For example, the paper arbitrarily excludes as much as 50% of the incumbents' costs for various functions, ostensibly on the theory that they are for retail functions. But it provides no basis for its various allocations of costs to retail, many of which are invalid on their face. The paper slashes corporate overhead by almost a third, without any explanation. Z-Tel Paper at 16 n.42. And it assigns to retail 50% of the building costs incumbents incur for warehouse space — which is used primarily to house the equipment used to repair and install outside plant — even though the need for such warehouse space (and the equipment it houses) is not in any way avoided when a carrier provides wholesale rather than retail service. The paper also assigns a portion of ARMIS switching costs to retail —

even though neither the states nor the CLECs have ever seriously contended that the relevant account contains retail costs that are or even could be avoided. *See id.* at 15. The extremity of the paper's overall conclusion — that "wholesale costs equal about 50% of retail costs," *id.* at 18 — is illustrated by the fact that even the most aggressive avoided cost discounts adopted by state commissions (or even those proposed by CLECs such as Z-Tel) do not come close to approaching that level.

Thus, it is clear that UNE-P rates have been ratcheted down well below costs based on increasingly hypothetical assumptions. This phenomenon has in turn discouraged investment by all carriers, impeded the development of facilities-based competition, and harmed the industry as a whole.

III. THE CLECS' CLAIMS THAT THE COMMISSION LACKS AUTHORITY TO GRANT THE RELIEF SOUGHT IN VERIZON'S FORBEARANCE PETITION CONSTITUTE NOTHING MORE THAN ATTEMPTS TO DELAY NEEDED REFORMS.

The Commission has ample authority to grant this petition and thereby reduce the most harmful effects of its pricing rules on an interim basis until it completes its broader proceeding to reform the TELRIC rules. The CLECs' contrary claims amount to little more than delay tactics that seek to divert the Commission from dealing with these harmful effects. Their arguments confuse discretionary Commission rules with requirements of the Act and rest on an impermissibly narrow interpretation of the Commission's forbearance authority.

A. The Act Does Not Require the Current UNE-P Pricing Rules.

The CLECs argue that the Act precludes grant of Verizon's petition because court rulings have upheld the Commission's creation of UNE-P and the current pricing rules, and those rules are therefore requirements of the Act. AT&T Comments at 13-20; MCI Comments at 4-12. But the fact that courts have found these regulations to be within the Commission's discretion does *not* mean that they are requirements of the Act. To the contrary, the Act does not require the TELRIC pricing rules or UNE-P or the UNE-P access charge rule, and the Commission has ample authority to reduce the harmful effects of those rules through forbearance.[39]

Both the Supreme Court and the Commission have recognized that nothing in the Act requires the TELRIC pricing rules. As the Court explained, the Act "leaves [the pricing] methodology largely subject to the Commission's discretion." *Verizon Communications v. FCC*, 535 U.S. 467, 499-500 (2002); *see* Verizon Petition at 12-13. The same is true of the Commission's creation of the UNE-P. As Chairman Powell has previously observed, the platform "wasn't in the statute. It was sort of a creative combination of the Commission."[40] Although the Supreme Court found that this "all elements" fiction was within the Commission's discretion, it did not suggest that the Act required UNE-P and in fact found the Act's provisions concerning combination of elements to be "ambiguous." *See Iowa Utils. Bd. v. FCC*, 525 U.S. 366, 392-94 (1999).

The Commission's rule that IXCs should pay per-minute access charges to platform-based CLECs also is not a requirement of the Act. The reality is that the incumbent continues to provide the exchange access service, and any suggestion that the UNE-P carrier plays any

---

[39] In any event, even if these rules were requirements of the Act, the Commission's forbearance authority explicitly encompasses the Act's requirements. 47 U.S.C. § 160(a) (Commission can forbear from enforcing "any regulation *or any provision of this Chapter*" (emphasis added)). As discussed below, the sole exception to this authority, the carveout in section 10(d), does not apply here.

[40] *Powell Defends Stance on Telecom Competition*, Television Digest (May 28, 2001); *see also Competition Issues in the Telecommunications Industry*, Hearings before the Senate Comm. on Commerce, Science, and Transportation, 108th Cong. at 9 (2003) (written statement of Michael K. Powell, Chairman, FCC) ("UNE-P is not a network element, nor does the statute provide for it as a complete entry vehicle. UNE-P is a consequence of previous regulatory decisions . . . .").

meaningful role other than to collect a check is simply a fiction. Because the per-minute access charges are intended to help recover the costs of the underlying network infrastructure, determining that the provider of the facilities — the incumbent — is entitled to those charges is well within the Commission's authority. That is particularly true since neither UNE-P nor TELRIC is required by the Act in the first place: if UNE-P remains available at TELRIC rates, the Commission has the power to condition that discretionary availability on the incumbent's receiving payment of per-minute access charges. *See* Verizon Petition at 17. Indeed, the Commission itself has determined once before that it had the authority under the Act not to apply this UNE-P access charge rule on an interim basis.[41/]

Nor is there any substance to CLEC claims that the Act requires the UNE-P access charge rule because otherwise UNE-P carriers would be prohibited from providing exchange access service in violation of the Act. AT&T Comments at 16-17. This argument fails on two levels. First, forbearance would not result in any such "impermissible use restriction" because a UNE-P carrier does not "use" UNEs to provide exchange access service in the first place. Indeed, unlike in the case of local service, where the UNE-P carrier at least performs some retail marketing functions, it performs *no* relevant function associated with exchange access service. Second, AT&T's argument that section 251(c)(3) entitles CLECs to use UNEs to provide "any" telecommunications service, AT&T Comments at 16-17, was squarely rejected by the D.C. Circuit in *Competitive Telecommunications Ass'n v. FCC*, 309 F.3d 8 (D.C. Cir. 2002). As the Court noted, "the vague[] phrasing chosen by Congress does not lend itself even to that

---

41/ First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15863-64, 15866-68 ¶¶ 719, 726-27 (1996) ("*Local Competition Order*").

suggestion." *Id.* at 12-14. Thus, the current rule permitting UNE-P carriers to collect per-minute access charges is in no way required by the Act.

Because the relevant UNE-P pricing rules are simply discretionary choices by the Commission, it has the authority to forbear from application of those rules. As a general matter, "[a]gencies . . . have leeway to change their interpretations of laws." *Harrington v. Chao*, 280 F.3d 50, 59 (1st Cir. 2002). That is particularly true where, as here, revisiting an interpretation is needed to ensure that the regulatory framework remains current and relevant. *See, e.g., Committee for Effective Cellular Rules v. FCC*, 53 F.3d 1309, 1317 (D.C. Cir. 1995) (emphasizing the "wide latitude" afforded agencies to change their policies to respond to "[t]echnological, commercial, and societal aspects of the . . . industry[]"); *Florida Cellular Mobil Communications Corp. v. FCC*, 28 F.3d 191, 196 (D.C. Cir. 1994). Moreover, the point of the Commission's forbearance authority under section 10 is to permit the Commission to determine that the application or enforcement of an otherwise valid rule would no longer be in the public interest. Section 10 would have no purpose if, as the CLECs suggest, its application were limited only to regulations that were outside the scope of what the Commission lawfully has discretion to adopt in the first place.

The CLECs also suggest that, even if the Commission's UNE-P pricing rules are not required by the Act, section 252(d)(1) requires "cost-based" rates, and the application of the resale standard to UNE-P and the collection of per-minute access charges by incumbents would violate this statutory requirement. AT&T Comments at 13-15. But this argument misses the point. Because UNE-P is not itself required by the Act, to the extent that the Commission decides in its discretion to retain that construct at all, the Act does not dictate the pricing that applies to UNE-P, and thus the Commission is free to exercise its own discretion in adopting appropriate pricing rules.

In effect, the Commission has the same discretion here as it has with respect to UNEs that are not required by section 251 but that BOCs still must provide under section 271. In that context, the Commission has determined that the cost-based standard of section 252 does not apply and instead that the rates simply must satisfy the just and reasonable requirements of sections 201 and 202. *See Triennial Review Order* ¶¶ 656-64. Similarly, the Commission has determined that when a UNE that previously was required no longer must be unbundled, it may, under section 201, assign whatever price it deems appropriate for that UNE as it transitions the UNE off the list. *See id.* ¶ 267. Here, because UNE-P also is not required by section 251, the Commission similarly has the authority to determine that the cost-based standard of 252 does not apply and that the section 201 requirement of just and reasonable rates governs UNE-P pricing instead.

As discussed in more detail below, the relief Verizon seeks here meets that statutory standard. UNE-P is the functional equivalent of resale, and Congress has already prescribed the pricing standard for resale that it deemed just and reasonable. Because that resale discount means that CLECs' costs will be below incumbents' retail rates in all markets, CLECs will have the opportunity to compete and build a customer base before investing in facilities even in areas where retail rates are below cost. Similarly, permitting incumbents to collect per-minute access charges is just and reasonable because those charges are intended to compensate for the facilities being used to originate, terminate, and transport long distance service, and it is the incumbents who own and provide those facilities, not the UNE-P carrier.

B. The Relief Verizon Seeks Is a Proper Request for Forbearance.

Contrary to the arguments of some parties, *see, e.g.,* Sprint Comments at 5-11; AT&T Comments at 10-13; MCI Comments at 2-4; Z-Tel Comments at 4-13; Covad Comments at 1, Verizon's petition seeks forbearance from two distinct rules, not the creation of new rules that require a notice and comment rulemaking. Verizon's request is appropriate under section 10.

First, Verizon seeks forbearance from the application of TELRIC only to a particular combination of network elements, the UNE platform. In granting this petition, the Commission would not have to create a new cost methodology or rules for this combination of elements. Instead, as explained above, the default rule of "just and reasonable" rates would apply — just as in the analogous context where UNEs are made available under section 271 but section 252 and the TELRIC rules do not apply. In this context, the cap on those rates would effectively be the retail-minus-avoided-cost pricing standard under existing Commission rules, because CLECs would not be willing to pay more than those rates for the UNE-P, which is the functional equivalent of resale. That result follows from the simple operation of marketplace dynamics; it does not amount to the formulation of a new UNE pricing rule that requires a notice and comment rulemaking.

Second, Verizon seeks forbearance from the rule, adopted in the *Local Competition Order*, entitling CLECs that lease the platform to collect per-minute access charges from IXCs. By forbearing from that rule, which is based entirely on the fiction that UNE-P carriers are providing exchange access service, the Commission would not be creating a new rule to take its place. Instead, it would simply be restoring the preexisting arrangement under which the incumbent doing the work, rather than some other carrier, is entitled to collect the per-minute access charges from the IXC.

For these reasons and others, there is no merit to the CLECs' reliance on the Commission's decision in *NYNEX*.[42] AT&T Comments at 11-12. In that case, the relief sought from certain rules would have required "replacing those rules with new ones." *NYNEX*, 12 FCC Rcd at 2314 ¶ 13. By contrast, here, Verizon's petition would not require the Commission to formulate any new rules, and forbearance is therefore appropriate.

Nor does it make any sense to argue, as several of the Petition's opponents do, Sprint Comments at 3-4; Z-Tel Comments at 10-11; MCI Comments at 4; NYDPS Comments at 2, that forbearance is somehow inappropriate because Verizon may have other procedural vehicles through which to seek similar relief, such as the upcoming TELRIC reform proceeding or the section 11 biennial review process. Section 10 directs that "the Commission *shall forbear*" from the application of existing rules whenever the substantive criteria of section 10(a) are met. *See* 47 U.S.C. § 160(a) (emphasis added). Nothing in the statute or the applicable case law permits the Commission to ignore that mandate on the ground that the Commission might someday grant alternative relief through some other procedural vehicle. To the contrary, because "Congress has established § 10 as a *viable and independent* means of seeking forbearance," reference to "another, very different, regulatory mechanism," such as a traditional notice-and-comment rulemaking proceeding, provides "no authority" for the Commission to abdicate its statutory responsibilities under section 10.[43]

---

[42] Order, *New England Telephone and Telegraph Company and New York Telephone Company Petition for Forbearance From Jurisdictional Separations Rules*, 12 FCC Rcd 2308 (1997) ("*NYNEX*").

[43] *AT&T v. FCC,* 236 F.3d 729, 737-38 (D.C. Cir. 2001) (emphasis added); *see also* Brief for FCC at 29, *Cellular Telecommunications & Internet Ass'n v. FCC*, No. 02-1264 (D.C. Cir. filed Feb. 3, 2003) (FCC is "*oblige[d]* . . . to evaluate the rule or statute pursuant to the criteria set out in section 10 and to determine on the basis of the record and its evaluation whether forbearance is required") (emphasis added); *see also* Memorandum Opinion and Order, *Petition*

Z-Tel separately argues that section 10(a) should be read to permit only limited carrier- or situation-specific "waivers" from regulatory requirements of general application. Z-Tel Comments at 7. This argument, too, is untenable. When its substantive standards are satisfied, section 10 requires the Commission to "forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, *or class of telecommunications carriers or telecommunications services*, in *any or some* of its or their geographic markets," and to "exercise th[at] authority . . . with respect to . . . *any service* offered by [the petitioning] carrier or carriers." 47 U.S.C. § 160(a), (c) (emphasis added).

C. Forbearance Here Would Be Consistent with Section 10(d).

The CLECs argue that the Commission cannot grant the petition because it cannot "forbear from applying *the requirements of section 251(c)*" before "those requirements have been fully implemented," in violation of section 10(d). *See* 47 U.S.C. § 160(d) (emphasis added). *See, e.g.*, AT&T Comments at 22-28; Z-Tel Comments at 16; CA PUC Comments at 12. This is wrong on three independent levels.

First, as discussed above, nothing in the Act, much less in section 251(c), "requires" either TELRIC or the availability of the UNE platform or the UNE-P access charge pricing rule. Rather, these are all the creatures of discretionary Commission regulation, not "requirements" of the Act itself. This point is dispositive, for section 10(d) only limits the Commission's right to "forbear from applying the requirements of section 251(c)," not to forbear from its own discretionary regulations.

---

of U S WEST Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance, 14 FCC Rcd 16252, 16269 ¶ 29 (1999) (*"NDA Order"*) ("Section 10 states, however, that we *must* forbear from enforcing section 272 if we find that" the three statutory conditions are met) (emphasis added).

AT&T implausibly contends that section 10(d) should be read as though it denied the Commission all authority to forbear *both* from the statutory requirements of section 251(c) *and* from the Commission's discretionary regulations under that provision. AT&T Comments at 23-24. But that argument, which contradicts AT&T's own position elsewhere,[44/] defies the statutory text. Whereas section 10(a) reflects a broad new grant of statutory authority that, for the first time, authorizes the Commission to forbear from "any regulation *or any provision* of this Act" (emphasis added), section 10(d) reflects only a narrow and temporary limit on that forbearance authority with respect to "the requirements of sections 251(c) or 271" themselves. Congress thereby restricted the Commission's authority to forbear from the requirements of those two specific statutory provisions for a limited period of time (i.e., until they are "fully implemented"); it did *not* restrict the Commission's authority to forbear from discretionary regulations that the Commission could eliminate anyway through a variety of other procedural mechanisms.[45/]

Second, even if the Commission could forbear from the application of TELRIC to the platform only after first determining that the requirements of section 251(c) "have been fully implemented" in Verizon's states, the Commission has in fact already made that determination.

[44/] *See* Letter from Mark Rosenblum, AT&T, to Chairman Powell and Commissioners, CC Dkt. No. 01-338, at 7 (Dec. 18, 2002) (arguing that, for preemption purposes, "the lawfulness of a state regulation [is measured] by its consistency with [the] *Act* and its purposes, *not* by its consistency with the Commission's regulations or policy preferences") (emphasis in original).

[45/] Nothing in the *1998 Biennial Review Order* is to the contrary, despite the misleading suggestion of some CLECs. *See* AT&T Comments at 23-24 & n.24; MCI Comments at 21. In that *Order*, the Commission stated only that it may not forbear from the requirements of sections 251 and 271, and it then noted that it was not *proposing* to forbear from those "provisions or the regulations implementing" them. Notice of Inquiry, *1998 Biennial Regulatory Review — Testing New Technology*, 13 FCC Rcd. 21879, 21896 ¶ 32 (1998). The Commission did not analyze (much less decide) whether such regulations were encompassed within section 10(d).

When it granted section 271 relief for all of Verizon's states, the Commission found that Verizon had "*fully implemented* the competitive checklist" of section 271. 47 U.S.C. § 271(d)(3)(A)(i) (emphasis added). Because the checklist incorporates by reference all applicable "requirements of section 251(c)," *id.* § 271(c)(2)(B)(ii), it follows that the Commission has also found that, in Verizon's states, those requirements have been "fully implemented."[46/]

Although MCI and AT&T argue that the term "fully implemented" has two mutually contradictory meanings in sections 10(d) and 271(d)(3)(A)(i), AT&T Comments at 24-29; MCI Comments at 23-28, they provide no basis for flouting the "normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning."[47/] That rule is particularly relevant here, since section 10(d) not only coexists in the same legislative enactment as section 271, but explicitly *addresses* section 271 as an exception in the very forbearance limitation at issue.

The CLECs contend that, as a policy matter, if the Commission can forbear from section 251(c)'s requirements once a BOC receives section 271 authorization, nothing would stop the BOC from "backsliding." AT&T Comments at 24-25; MCI Comments at 24-26. But this argument wrongly presumes that the section 271 checklist requirements immediately vanish once a section 271 application is granted. In reality, the Commission retains authority to enforce those requirements until and unless it affirmatively finds that the substantive criteria of section 10(a)

46/ Of course, this does not mean that the checklist requirements in section 271 are immediately inapplicable once a section 271 application is granted. Rather, at that point, once those requirements are "fully implemented," the Commission has the authority to forbear from some aspect of those requirements *if* it finds that the statutory criteria of section 10 are met, as they are here.

47/ *Commissioner v. Lundy*, 516 U.S. 235, 250 (1996) (quoting *Sullivan v. Stroop*, 496 U.S. 478, 484 (1990)).

are met as to a specific checklist requirement. Thus, the Commission would retain any and all existing authority to enforce, and to prevent "backsliding" with respect to, all requirements of the competitive checklist that continue to apply. And by definition, the only requirements that would not continue to apply are those that the Commission expressly finds are unnecessary under the standards of section 10(a) — in which case there obviously is no backsliding concern.

Finally, even if section 251 required TELRIC or the UNE-P — which it does not — section 10(d) does *not* state that the Commission may not forbear from applying *any* requirement of section 251 until it finds that *all* such requirements have been "fully implemented." Instead, it provides only that "the Commission may not forbear from applying the requirements of section 251(c) . . . until it determines that *those* requirements" — *i.e.*, the ones from which forbearance is sought—"have been fully implemented." 47 U.S.C. § 160(d) (emphasis added). Here, Verizon seeks forbearance only from the application of TELRIC to the platform and from the rule requiring IXCs to pay access charges to platform-based CLECs rather than incumbents.

IV. VERIZON HAS MET THE STATUTORY STANDARDS FOR FORBEARANCE.

The record before the Commission demonstrates that Verizon has satisfied each of the three prerequisites for forbearance. The current UNE-P pricing rules are deterring investment and the development of facilities-based competition, and forbearance from these rules is required as soon as possible to protect consumers and the public interest. The CLECs' contrary argument ultimately amounts to an argument that UNE-P at TELRIC rates should be viewed as the end-state for mass market competition, a view this Commission, and Congress, have already rejected.[48/]

48/ A few commenters suggest that Verizon's petition does not comply with 47 C.F.R. § 1.53 because, although it was captioned as a "Petition for Forbearance," the caption did not expressly

A. The Current UNE-P Pricing Rules Are Not "Necessary" to Ensure that Rates Are Just, Reasonable, and Nondiscriminatory, and Are in Fact Inconsistent with That Goal.

The CLECs claim that Verizon's petition does not satisfy the first prong of the test for forbearance in section 10(a)(1) of the Act because eliminating the UNE-P pricing rules would lead to UNE-P rates that are not "just and reasonable" and that are "unreasonably discriminatory." Their argument is essentially nothing more than a contention that the *only* "just and reasonable" and nondiscriminatory rate for UNE-P is one based on TELRIC. *See, e.g.*, AT&T Comments at 33-35; Z-Tel Comments at 19; MCI Comments at 13-14. As AT&T puts it, in "the UNE context, Congress has specifically directed that *only* 'cost-based' rates can satisfy the statutory requirement that charges be just, reasonable and nondiscriminatory." AT&T Comments at 33-34. But leaving aside that there are many variants of "cost-based" rates — many of which are far more economically appropriate than TELRIC — the CLECs simply have it wrong. As discussed above, the Act does not require UNE-P at all, and as such does not require that the Commission use any particular pricing standard for UNE-P.

Once the fallacious argument that the Act dictates a specific definition of what is a "just and reasonable" charge for UNE-P is discarded, there is nothing of substance left to the CLECs' arguments. This is hardly surprising: the current UNE-P pricing rules cannot be "necessary" to

---

refer to 47 U.S.C. § 160. *See, e.g.*, Z-Tel Comments at 11 & n.18. This argument is frivolous: There could be no doubt that Verizon was invoking 47 U.S.C. § 160 as the basis for its petition because that is the provision that authorizes the Commission to grant forbearance. The Commission's Public Notice setting a comment schedule explicitly noted that Verizon had filed "a petition for expedited forbearance, *pursuant to section 10 of the Telecommunications Act of 1996, 47 U.S.C. § 160*." *Pleading Cycle Established for Verizon Petition for Expedited Forbearance from the Commission's Current Pricing Rules for the Unbundled Network Elements Platform*, Public Notice, DA 03-2189 (rel. July 3, 2003) (emphasis added). And the commenters clearly understood this, since they devote hundreds of pages to whether the criteria in 47 U.S.C. § 160 have been met.

ensure "just and reasonable," nondiscriminatory rates for the services and facilities that make up the UNE-platform, because those pricing rules are fundamentally *inconsistent* with just and reasonable, nondiscriminatory rates. No matter how the term "necessary" may be defined, *CTIA v. FCC*, No. 02-1264, slip op. at 17 (D.C. Cir. June 6, 2003), rules that *disserve* the stated objective cannot possibly qualify. The UNE-P pricing rules systematically undercompensate the incumbents for even their forward-looking costs and, as described in detail above, have drastically distorted investment incentives in the telecommunications market. Similarly, the fiction that permits UNE-P carriers to receive exchange access charges diverts revenue intended to compensate for the underlying network infrastructure away from the underlying facilities-based provider. In these circumstances, the existing UNE-P pricing rules simply cannot be defined as just *or* reasonable.

By contrast, rates based on the wholesale discount are *de facto* just and reasonable and nondiscriminatory since that standard was prescribed by Congress itself. The resale discount means that CLECs' costs are substantially below the incumbents' retail rates, and it accordingly ensures that CLECs have an opportunity to enter the market, compete, and build a customer base before investing in their own facilities, even where retail rates are set artificially. If the wholesale discount is "just and reasonable" and nondiscriminatory under section 251(c)(4) of the Act — and no other conclusion is possible — it is equally just and reasonable when the same service is provided in the guise of UNE-P.

Similarly, the CLECs are wrong in claiming that UNE-P rates based on the resale standard would result in a "price squeeze" because an incumbent's actual costs would be lower than the wholesale discounted rate. *See* Z-Tel Comments at 19. This argument — which the CLECs have trotted out with respect to *TELRIC rates* in every 271 proceeding and the

Commission has repeatedly rejected[49] — is equally unconvincing here. In the resale context, the incumbent cannot take advantage of supposedly lower costs by reducing retail rates, because any such reduction would also result in a corresponding reduction in the CLEC's *costs* (i.e., the wholesale rate). Thus, even if the incumbent reduces its retail prices, the CLEC will also get a lower wholesale rate, and it can continue to compete with the incumbent on price and not be "squeezed" out of the market. And because the resale pricing standard provides a discount even where retail rates are set at artificially low levels, the CLEC can enter the market, compete, and build a customer base before investing in its own facilities and then transitioning its customers to its own facilities. That is the goal and the key advantage of the resale discount: as the Commission has made clear, the Act is not designed to provide any carrier with an entitlement to any specific level of profits, but simply with an opportunity to compete. *See, e.g., Vermont 271 Order* at 7664 ¶¶ 69-70.

For similar reasons, the CLECs' arguments that forbearance from the Commission's rule permitting UNE-P carriers to collect per-minute access charges would be unjust and unreasonable or discriminatory also fail. Forbearance from this rule would simply provide incumbents with the revenues that this Commission has explicitly approved for the provision of the exchange access services that the incumbents in fact provide. The CLECs' arguments that this would result in recovery that is not TELRIC-based, *see* AT&T Comments at 18, again miss

---

49/ *See, e.g.*, Memorandum Opinion and Order, *Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in Vermont*, 17 FCC Rcd. 7625, 7661-66 ¶¶ 65-73 (2002) ("*Vermont 271 Order*"); Memorandum Opinion and Order, *Application by Verizon New Jersey Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in New Jersey*, 17 FCC Rcd. 12275, 12359-62 ¶¶ 169-75 (2002).

the point because the Act neither requires UNE-P nor dictates the pricing rules that must apply to it.

AT&T and others wrongly claim that permitting incumbents to collect per-minute access charges along with TELRIC rates for UNE-P would be unjust and unreasonable because it would result in "double recovery." AT&T Comments at 18-19; MCI Comments at 10; Focal/McLeodUSA/PacWest/TDS Comments at 34. Per-minute access charges will apply to long distance traffic, while per-minute UNE switching charges will apply to local traffic. Thus, for any given minute of use, the incumbent would collect one, but not both, charges and there would be no double recovery. AT&T asserts that double recovery would still be possible in states where UNE switching charges are entirely flat-rated and have no usage sensitive component. AT&T Comments at 19. However, not one of the 31 state commissions in Verizon's service areas have set entirely flat-rated switching charges in recognition of the fact that switching costs are partially usage sensitive, and even AT&T has typically proposed a minute of use charge for UNE switching in Verizon states.[50/] Similarly, the CLECs' claim that allowing incumbents to collect per-minute access charges from IXCs would be unreasonable because such rates contain implicit subsidies, *see, e.g.*, MCI Comments at 12, simply ignores the fact that exchange access charges are set by regulators, are designed to help recover the costs of the underlying network, and already have been deemed to be just and reasonable. Moreover, in the case of interstate access charges, their claim ignores that the *CALLS Order* removed implicit

---

[50/] While no state commission in Verizon's service areas has gone to the extreme of establishing wholly flat-rated switching charges, a recent arbitration decision by the Wireline Competition Bureau does adopt a fairly radical and untested new pricing structure for switching that converts most end office switching charges to flat rates. If that new rate structure, which is not yet in effect, survives review, then a pricing adjustment would be required to ensure that Verizon recovers the appropriate amount for the provision of exchange access service.

subsidies from those rates.[51] Indeed, the claim that the per-minute access charges are unjust and unreasonable is belied by the fact that the *CALLS Order* itself was the product of arms-length negotiations between incumbents and IXCs, including AT&T, who clearly would not have agreed to the resulting charges unless they thought they were in fact reasonable. Thus, it is the rule that prohibits incumbents from recovering per-minute access charges notwithstanding that they continue to provide exchange access that is unjust and unreasonable.

B. The Current UNE-P Pricing Rules Are Not Necessary To Protect Consumers.

The current UNE-P pricing rules, far from protecting consumers, affirmatively harm them by contributing to a decline in investment and discouraging the development of facilities-based competition. The CLECs' claim that UNE-P competition at current prices is needed to protect consumers by providing them with a competitive choice ignores the obvious limits on UNE-P based competition and the real competitive choices that consumers already have and that would grow even more if the disincentives created by the current UNE-P pricing rules were removed.

The CLECs' primary claim is that the current UNE-P pricing rules are necessary to protect consumers because forbearance from them allegedly would eliminate the primary competitive choice that consumers have. AT&T Comments at 39-40; MCI Comments at 15-18. This claim fails for at least three reasons. First, UNE-P competition does not provide consumers with a meaningful competitive choice. The only supposed "competition" UNE-P carriers can offer is in terms of marketing and similar retailing functions. Because UNE-P carriers rely on

---

[51] *See* Sixth Report and Order, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low Volume Long Distance Users, Federal-State Joint Board on Universal Service*, 12 F.C.C. Rcd. 12962 ¶ 3 (2000).

the same underlying facilities as the incumbent, they have little ability to offer differentiated services or new functionalities.

Second, as discussed above, the current UNE-P pricing rules actually operate to *curtail* consumer choices by creating disincentives for all carriers to invest and thereby deterring the development of facilities-based competition. It is only through competing facilities platforms that consumers will receive the benefits of widespread innovation, differentiated products, and genuine cost reductions. That is already evident in the increased competitive choices that consumers have from competing platforms in the form of bundled packages in which service providers provide an array of service options for a single price. *See* Verizon Petition at 22.

Third, forbearance still would permit CLECs to use UNE-P and/or resale to provide service and compete as to retailing functions.[52/] As noted above, the availability of the resale discount ensures that CLECs' costs are always below the incumbents' retail rates, and thus that CLECs have an opportunity to compete for customers *before* investing in their own facilities even in areas with below-cost retail rates. And nothing restricts CLECs' ability to offer various service packages using resale: Verizon, for example, offers *seventy-five* different products, services, calling plans and optional customer calling plans and private line features for resale, which CLECs can obtain and provide in various bundled packages with or without their own additional offerings. The only difference if Verizon's petition were granted would be that carriers using UNE-P would no longer be able to take advantage of the artificially low TELRIC

52/ For this reason, Z-Tel's claim (Z-Tel Comments at 29) that it can use UNE-P to provide services that it cannot with resale, even if it were true, would be irrelevant. Verizon's petition would not result in the elimination of UNE-P, but merely result in a more rational pricing structure for UNE-P.

rates and the consequent large profit margins and accompanying uneconomic arbitrage that they produce.

AT&T and others attempt to minimize these choices by suggesting that intermodal competition from wireless, cable telephony, and other sources is minimal and confined to niche markets. AT&T Comments at 47. But this flatly contradicts statements AT&T has made elsewhere. For example, an AT&T presentation to investors stated that one of the "key issues that the RBOCs face" is "how to compete against the ~137 million wireless lines."[53] AT&T's President has also observed that "'[i]nexorably, . . . cable and wireless are going to eat into [the incumbents'] share [of the local market].'"[54]

These statements are confirmed by marketplace realities. While AT&T focuses on the number of current subscribers to cable telephony, it ignores that cable telephony is now available to 15 percent of U.S. homes.[55] And, contrary to AT&T's cites to year-old news accounts, a number of cable companies have in recent months announced additional cable telephony deployments. *Report on Negative Effect of the UNE Platform* at 24-26. For example, in May, Time Warner Cable deployed a commercial VoIP offering in its cable system in Maine, and it plans to roll out this service in additional markets by the end of the year.[56] Likewise,

---

[53] AT&T, *AT&T UNE Overview* at 37 (Sept. 17, 2002).

[54] Scott Woolley, *Bad Connection*, Forbes (Aug. 12, 2002) (quoting AT&T president David Dorman); *see also AT&T UNE Overview* at 37 (noting that a "key issue[] that the RBOCs face" is "how to improve their efficiency so they can compete effectively with complete facilities-based carriers (*e.g.*, CATV) for telephony and DSL.").

[55] Ninth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 17 FCC Rcd 26901, 26926-27 ¶¶ 49-51 (2002).

[56] M. Berniker, *Time Warner Cable Beats Rivals to VoIP Punch*, Internetnews.com (May 22, 2003); F.J. Governali, *et al.*, Goldman Sachs, *VoIP – The Enabler of Real Telecom Competition* at 12 (July 7, 2003).

Cablevision has started to offer telephony service in areas of New York, and the company plans to expand this offering to *all* of its high-speed customers by the end of this year.[57] Investment analysts have pointed to cable companies' rollout of cable telephony as "the largest risk to Bell fundamentals over the next 5 years," noting that "the impact on margins is increasingly evident today."[58] Goldman Sachs, for example, predicts that by 2006 there will be nearly 4 million residential customers using VoIP cable telephony, with the number rising to nearly 8 million by 2008.[59] As one analyst described, "[t]he paranoia that I think most of the ILECs feel today is about true VoIP — the IP technology and the likelihood that the cable companies are going to be able to launch that broadly in the next few years."[60] Similarly, there can be no question that wireless telephony has already taken not only subscribers, but more significantly, large quantities of traffic from wireline networks. Moreover, it was the new pricing plans from wireless

---

57/ Cablevision, *OptimumVoice: How Do I Get It?*, http://www.optimumvoice.com/index.jhtml?pageType=how_to_get ; J. Moynihan, *et al.*, Merrill Lynch, *Voice Over Broadband* at Table 1 (June 24, 2003); *see also* Chris Larsen, Prudential Finance, *Wireline Services: Meeting with Voice Over Internet Company Vonage Sheds Light on Disruptive Technology* (May 21, 2003) (noting that Vonage, which offers a so-called "disruptive technology to the circuit switched world," is already working on private label contracts); Chris Larsen, Prudential Finance, *VZ: Implications for Verizon as Cablevision Announces VOIP Rollout Later in August,* at 1 (August 6, 2003).

58/ John Hodulik, UBS Investment Research, *Cable Telephony Competition: Who Gets It?* at 1 (Aug. 7, 2003).

59/ F.J. Governali, *et al.*, Goldman Sachs, *VoIP – The Enabler of Real Telecom Competition* at Exh. 3 (July 7, 2003)*; see also id.* at 1 (noting that "VoIP is here now- it is not some far off event that can be overlooked," and observing that "all segments of the telecom industry, . . . will feel the impact of VoIP as it gains more traction.").

60/ S. Brodeur, President, Cambridge Strategic Management Group, testimony before the Subcommittee on Telecommunications and the Internet of the House Committee on Commerce and Energy (Feb. 5, 2003); *see also* Bernstein Research, *Cable and Telecom: New Cable Telephony Business Models May Prove Disruptive to Both Sides*" at 6 (June 27, 2003) (noting "significant risk" to incumbents with exposure to Cablevision and Time Warner's VoIP competition).

providers that bundled local and long distance minutes for a single flat rate that led both wireline carriers and other providers to offer similar packages.

The competing services from wireless carriers, cable telephony providers, voice over IP, e-mail, and instant messaging, as well from UNE-L and other facilities-based wireline carriers, ensure that incumbents cannot, as CLECs charge, exercise "market power" and raise prices to consumers. AT&T Comments at 47-48. Even if that were a danger, price caps and other forms of retail rate regulation would foreclose it.

Ultimately, it is facilities-based competition that will protect consumers and offer them meaningful competitive choice, not the synthetic competition created by UNE-P carriers that have no facilities and can only compete on very limited dimensions. While the Commission has noted that intermodal competition is still developing, *see Triennial Review Order* ¶¶ 443-46, the removal of the disincentives created by the current UNE-P pricing rules will accelerate the pace of intermodal facilities deployment and the attendant benefits for consumers. For example, Credit Suisse First Boston noted that it "turned pessimistic about the extent to which Cox Communications will generate money from offering local telephone service over its cable TV systems" because "the long distance carriers' use of UNE-P has picked up speed of late."[61/] Similarly, Legg Mason, responding to WorldCom's plan to expand its UNE-P offerings, observed: "the more successful the plan is, the more it will reduce the attractiveness of the telephony opportunity for cable."[62/] Because the current UNE-P pricing rules are actually

---

61/ George Mannes, *Cox's Prospects for Growth May Be Fading*, The Street.com (Sept. 19, 2002), *available at* htttp://www.thestreet.com/tech/georgemannes/10043045.html (citing Credit Suisse First Boston analyst Lara Warner).

62/ B. Levin, *et al.*, Legg Mason Wood Walker, *WorldCom/MCI Bundled Phone Offer Challenges Rivals, Regulators* at 2 (Apr. 23, 2002).

driving the market away from facilities-based competition and toward growth in UNE-P, forbearing from those pricing rules, not perpetuating them, is the best way to protect consumers.

C. Forbearance is Consistent with the Public Interest.

For all the reasons stated above, forbearance here is consistent with the public interest. The CLECs' arguments that forbearance would *not* serve the public interest are simply reiterations of their claims that UNE-P pricing must be subject to the TELRIC framework and that the artificial and uneconomic competition UNE-P engenders is preferable to the genuine facilities-based competition that forbearance from the UNE-P pricing rules would encourage. All of these arguments are unavailing. The telecommunications industry — both carriers and the customers those carriers serve — sorely need the market correction that forbearance would help create. As the Commission recognized throughout the *Triennial Review Order*, rationalizing unbundling burdens will help create the proper incentives for facilities investment and technological development.

There is no question that the public interest would benefit from this turn of events. It will promote genuine service differentiation, technological experimentation and advances, and the deployment of robust new facilities. In an era where the need for redundant architecture becomes ever more prevalent — a need the CLECs nod to, but then ignore — the value of new facilities investment cannot be overstated. Forbearance from the UNE-P pricing rules is not only consistent with the public interest, but long overdue.

CONCLUSION

For the foregoing reasons, the Commission should forbear from applying its current pricing rules to the UNE-P.

Respectfully submitted,

Karen Zacharia /SG

Of Counsel:
Michael E. Glover

Karen Zacharia
Leslie V. Owsley
Donna M. Epps
Verizon
1515 North Court House Road
Fifth Floor
Arlington, Virginia 22201
(703) 351-3100

Lynn R. Charytan
Samir C. Jain
Wilmer, Cutler & Pickering
2445 M Street, NW
Washington, DC 20037-1420
(202) 663-6000

Evan T. Leo
Kellogg, Huber, Hanser, Todd & Evans
1615 M Street, NW
Washington, DC 20036
(202) 326-7900

Counsel for Verizon Telephone Companies

September 2, 2003